



8011-01p
SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-71838; File No. SR-NYSEMKT-2014-22)

April 1, 2014

Self-Regulatory Organizations; NYSE MKT LLC; Notice of Filing of Proposed Rule Change Amending Rule 98 - Equities to Adopt a Principles-based Approach to Prohibit the Misuse of Material Nonpublic Information and Make Conforming Changes to Other Exchange Rules

Pursuant to Section 19(b)(1)¹ of the Securities Exchange Act of 1934 (the “Act”)² and Rule 19b-4 thereunder,³ notice is hereby given that, on March 18, 2014, NYSE MKT LLC (the “Exchange” or “NYSE MKT”) filed with the Securities and Exchange Commission (the “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the self-regulatory organization. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

The Exchange proposes to amend Rule 98 - Equities to adopt a principles-based approach to prohibit the misuse of material nonpublic information and make conforming changes to other Exchange Rules. The text of the proposed rule change is available on the Exchange’s website at www.nyse.com, at the principal office of the Exchange, and at the Commission’s Public Reference Room.

II. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the self-regulatory organization included

¹ 15 U.S.C.78s(b)(1).

² 15 U.S.C. 78a.

³ 17 CFR 240.19b-4.

statements concerning the purpose of, and basis for, the proposed rule change and discussed any comments it received on the proposed rule change. The text of those statements may be examined at the places specified in Item IV below. The Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant parts of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and the Statutory Basis for, the Proposed Rule Change

1. Purpose

The Exchange proposes to amend Rule 98 – Equities (“Rule 98”) to adopt a principles-based approach to prohibit the misuse of material nonpublic information by a member organization that operates a DMM unit and make conforming changes to other Exchange rules. The proposed rule changes would provide more flexibility for how a member organization may organize its DMM unit. The Exchange believes that the proposed rule change adopts an approach more similar to the rules governing equity market makers on NYSE Arca Equities, Inc. (“NYSE Arca”), the NASDAQ Stock Market LLC (“Nasdaq”), and the BATS Exchange, Inc. (“BATS”),⁴ while maintaining certain specified protections that reflect the unique role of DMMs at the Exchange.⁵ The

⁴ See Securities Exchange Act Release No. 60604 (Sept. 2, 2009), 76 FR 46272 (Sept. 8, 2009) (SR-NYSEArca-2009-78) (Order approving elimination of NYSE Arca rule that required market makers to establish and maintain specifically prescribed information barriers, including discussion of NYSE Arca and Nasdaq rules). See also Securities Exchange Act Release No. 61574 (Feb. 23, 2010), 75 FR 9455 (Mar. 2, 2010) (SR-BATS-2010-003) (Order approving amendments to BATS Exchange, Inc. (“BATS”) Rule 5.5 to move to a principles-based approach to protecting against the misuse of material, non-public information, and noting that the proposed change is consistent with the approaches of NYSE Arca and Nasdaq).

⁵ This proposed rule change is not intended to address the rules governing options market makers.

proposed changes will provide member organizations operating DMM units with the ability to integrate DMM unit trading with other trading units, while maintaining narrowly tailored restrictions to address that DMMs while on the Trading Floor may have access to certain Floor-based non-public information. The proposed rule change will also enable DMM units to maintain procedures and controls to prevent the misuse of material, non-public information that are effective and appropriate for that member organization.

As discussed in more detail below, the Exchange proposes to redefine the structure of a DMM unit by deleting the definitions of “aggregation unit” and cross reference to Rule 200 of Regulation SHO (“Regulation SHO”)⁶ and “integrated proprietary aggregation unit” and redefining the term “DMM unit.” The Exchange believes that these proposed revisions will enable member organizations to integrate DMM units with other trading operations within the member organization, including, if applicable, a customer-facing operation, subject to Exchange and federal rules that prohibit the misuse of material nonpublic information. In addition, in order to streamline the rule, the Exchange proposes several non-substantive clarifying and conforming changes to the provisions of Rule 98 that govern these areas. The Exchange also proposes to eliminate duplicative provisions in the rule regarding back-office operations provided by an approved person or member organization. Finally, the Exchange proposes to delete rules relating to the DMM that are obsolete.

⁶ 17 CFR Part 242.200.

A. Background

Rule 98, which is based on New York Stock Exchange LLC (“NYSE”) Rule 98, which was last amended in 2008,⁷ incorporates various organizational structures for operating a DMM unit. Rule 98(c) provides for the operation of a “DMM unit,” which can be either a stand-alone member organization or an “aggregation unit”⁸ within a member organization. As a general matter, unless otherwise specified in Rule 98, a DMM unit must maintain the confidentiality of both DMM confidential information and non-public orders.⁹ A DMM unit therefore must not permit either other aggregation units of the member organization or its approved person(s) to have access to DMM confidential information or non-public order information.¹⁰

Rule 98 defines the terms “non-public order information” and “DMM confidential information” separately. In the case of “non-public order information,” the Exchange seeks to protect price-sensitive non-DMM trading information that is not publicly available or that is shared with the DMM with an expectation of privacy. Thus, this definition captures any information relating to order flow at the Exchange, including verbal indications of interest made with an expectation of privacy, electronic order interest, e-quotes, reserve interest, or information about imbalances at the Exchange, that

⁷ See Securities Exchange Act Release No. 58329 (Aug. 6, 2008), 73 FR 48260 (Aug. 18, 2008) (SR-NYSE-2008-45). The NYSE is filing to amend Rule 98. See SR-NYSE-2014-12.

⁸ An “aggregation unit” is defined in Rule 98(b)(11) as any trading or market-making department, division, or desk that meets the requirements of the definition of “independent trading unit” pursuant to Rule 200 of Regulation SHO.

⁹ See Rule 98(c)(2)(A).

¹⁰ See Rule 98(c)(2)(A)(i) and (ii).

is not publicly-available on a real-time basis via an Exchange-provided datafeed, such as NYSE OpenBook®,¹¹ or otherwise publicly available.

“DMM confidential information” refers to principal or proprietary trading activity of a DMM unit at the Exchange in the securities allocated to it pursuant to Rule 103B - Equities, including the unit’s positions in those securities, decisions relating to trading or quoting in those securities, and any algorithm or computer system that is responsible for such trading activity and that interfaces with Exchange systems.

Rule 98(d) permits a member organization to operate the DMM business within a larger aggregation unit referred to as a “integrated proprietary aggregation unit,” which may only engage in proprietary trading activity, including electronic market making. Rules 98(d) and (f)(2) set forth the types of information barriers required within such a unit to separate the DMM trading at the Exchange from the trading by the unit’s “upstairs” desk’s trading in assigned securities in away markets or trading in related products.¹² In particular, the rule requires the DMM unit to protect both non-public order information and DMM confidential information. When providing risk management to the DMM unit, the integrated proprietary aggregation unit may see traded positions of the

¹¹ NYSE OpenBook® provides aggregated limit-order volume that has been entered on the Exchange at price points for all NYSE MKT-traded securities.

¹² “Related products” are defined as any derivative instruments that are related to a security allocated to a DMM unit, including options, warrants, hybrid securities, single-stock futures, security-based swap agreement, a forward contract, or any other instrument that is exercisable into or whose price is based upon or derived from a security listed on the Exchange. See Rule 98(b)(15). The Exchange proposes to make non-substantive edits to this definition to conform to other changes made to Rule 98, and, as discussed below, renumber the rule accordingly.

DMM unit that have been printed to the Consolidated Tape, but cannot see where the DMM unit is quoting.¹³

When a DMM unit operates within an integrated proprietary aggregation unit or engages in off-Floor trading of products related to securities assigned to the DMM unit, Rule 98 specifically prohibits an individual DMM who moves off of the Floor of the Exchange from making DMM confidential information available to off-Floor personnel or systems of the integrated proprietary aggregation unit.¹⁴ Senior managers of the approved person or parent member organization may provide general oversight to the DMM unit, provided that if the senior manager receives any DMM confidential information or non-public order information, he or she must not use such information to directly or indirectly influence trading based on that confidential information.¹⁵

Rule 98 further provides that individuals or systems, including computer algorithms, that are either responsible for trading in related products within the DMM unit or engaging in risk management on behalf of the DMM unit, are restricted from having access to DMM confidential information.¹⁶ As noted above, the limited exceptions permit the persons or systems responsible for managing the risk of the DMM unit to have electronic access to the DMM unit's trades at the Exchange in securities allocated to the DMM unit, provided that such trades have been printed to the

¹³ See Rule 98(f)(1)(v) and 98(f)(2)(A).

¹⁴ See Rule 98(d)(2)(B)(iv) and 98(f)(1)(A)(iii).

¹⁵ See Rule 98(c)(2)(E).

¹⁶ See Rule 98(f)(1)(A)(i), 98(f)(2)(A), and 98(f)(3)(C)(2).

Consolidated Tape, and to electronically direct the trading of the DMM unit, subject to the DMM rules.¹⁷

In addition to specifying trading restrictions, Rule 98(e) provides that a DMM unit can share non-trading related services with a parent member organization or approved persons. However, to share non-trading related services, a DMM unit must obtain approval from NYSE Regulation and show that it has policies and procedures to maintain the confidentiality of DMM confidential information and non-public order information.

Because not all firms were immediately approved under “new” Rule 98, which was last amended in 2008, the Exchange kept the pre-2008 version of Rule 98 in its rulebook as “Rule 98 Former - Equities” (“Rule 98 Former”). Because Rule 98 Former was referenced in a number of other Exchange rules, certain Exchange rules have double references depending on whether the DMM is approved under Rule 98 Former or the current rule.¹⁸

All DMM firms are now approved to operate under Rule 98, and are no longer subject to “Rule 98 Former.”

B. Proposed Amendments to Rule 98

The Exchange proposes to amend Rule 98 to adopt a more principles-based approach that would permit a member organization operating a DMM unit to maintain and enforce its own policies and procedures to, among other things, prohibit the misuse of material nonpublic information and eliminate requirements that specify how a member

¹⁷ See Rule 98(f)(1)(A)(v), 98(f)(2)(a)(i), and 98(f)(3)(c)(iii) and (iv).

¹⁸ See Rules 104T(a)(Former) - Equities, 105(a) Former - Equities, 105(b) Former - Equities, 105(d) Former - Equities, 105 Guidelines section (m) Former - Equities, and 113 Former - Equities.

organization must organize its DMM unit within the firm. While the proposed changes would provide the ability for member organizations to integrate their DMM units, the Exchange does not believe that the amendments will reduce in any way the protections against the misuse of material nonpublic information. Rather, the Exchange believes that by adding a principles-based approach that generally prohibits the misuse of material non-public information, the amended rule will provide for broader protections than the current rule, which protects only certain defined non-public information.

To achieve the goal of enabling greater integration of DMM units within a member organization, the Exchange proposes to revise the definitions set forth in Rule 98(b) to eliminate the various structures and instead use a single term to refer to DMM operations. As proposed, the term “DMM unit” would be amended to mean a trading unit within a member organization that is approved pursuant to Rule 103 - Equities to act as a DMM unit. Accordingly, the Exchange proposes to eliminate the requirement that a DMM unit be an “aggregation unit”, which is currently defined to mean any trading or market-making department, division or desk that meets the requirements of the definition of “independent trading unit” pursuant to Rule 200 of Regulation SHO.¹⁹

The Exchange proposes to decouple the Rule 98 definition from Regulation SHO in part because the two rules seek to achieve different purposes. Rule 200(f) of Regulation SHO sets forth the requirements for qualifying as an “independent trading unit” for the purpose of order marking requirements under Rule 200. In practice, broker dealers use information barriers to meet the requirements of an independent trading unit

¹⁹ The Exchange proposes to delete rule provisions that reference the terms “aggregation unit” and “integrated proprietary aggregation unit.” See, e.g., Rule 98(c)(2)(B).

under Regulation SHO. By contrast, Rule 98 does not concern the netting of position information. While member organizations operating DMM units would be required to comply with Regulation SHO, the Exchange does not believe that it needs to prescribe in its rules how a firm must structure its DMM operations for purposes of complying with Regulation SHO.

For similar reasons, the Exchange does not believe it needs to maintain a definition unique to the Exchange and DMMs of an “integrated proprietary aggregation unit.” This definition contemplates a DMM unit being part of an aggregation unit that engages in only proprietary trading activity. While a member organization may choose to structure in this manner, the Exchange does not believe it needs to be required. Rather, the Exchange believes that Rule 98 should provide flexibility for a member organization to structure its business, including any DMM operations, in a manner that a member organization believes is appropriate for its business purposes, subject to requirements to protect against the misuse of material, non-public information, as discussed below.

The Exchange proposes additional changes to Rule 98(b) to delete definitions that are no longer necessary in the revised rule. Specifically, the Exchange proposes to delete the definitions for “DMM API,” “DMM account,” “customer-facing department,” and “non-trading related services.” The terms DMM API and DMM account were based on Rule 104 before it was amended in 2008. Accordingly, the Exchange believes that these definitions are now obsolete. In addition, because the proposed rule changes are intended to provide principles-based instruction on how to operate a DMM unit, the rule no longer needs to define terms that support the current, more prescriptive rule text. The Exchange proposes to delete the definitions of “DMM” and “approved person” as duplicative of the

definitions set forth in Rules 2(i) - Equities and 2(c) - Equities. The Exchange proposes to make non-substantive edits to the definition of “related products.” The Exchange also proposes to make conforming amendments to Rule 2(j) - Equities.

With these proposed definition changes, the Exchange believes that a member organization operating a DMM unit would be better positioned to integrate its DMM operations. For example, if a member organization engages in market-making operations on multiple exchanges, it may be optimal for a firm to house its DMM operations together with the other market-making operations, even if such operations are customer-facing. Another variation could be if a firm chooses to include all of its equity trading, including customer-facing operations, within a single independent trading unit. The Exchange believes that providing member organizations with the ability to integrate DMM operations could promote liquidity at the Exchange because the DMM operations would be part of a larger unit with greater sources of liquidity.²⁰

The Exchange notes that notwithstanding how a member organization chooses to structure its operations, that firm would need to meet the requirements of Section 15(g) of the Act,²¹ which requires every registered broker or dealer to “establish, maintain, and enforce written policies and procedures reasonably designed, taking into consideration

²⁰ The Exchange notes that under Regulation SHO, determination of a seller’s net position is based on the seller’s position in the security in all proprietary accounts. See Securities Exchange Act Release No. 50103 (July 28, 2004), 69 FR 48008, 48010, n.22 (Aug. 6, 2004); see also Securities Exchange Act Release Not 48709 (Oct. 29, 2003), 68 FR 62972, 62991 and 62994 (Nov. 6, 2003); Letter from Richard R. Lindsey, Director, Division of Market Regulation, to Roger D. Blanc, Wilkie Farr & Gallagher, SEC No-Action Letter, 1998 SEC No-Act. LEXIS 1038, p. 5 (Nov. 23, 1998); Securities Exchange Act Release No. 30772 (June 3, 1992), 57 FR 24415, 24419 n.47 (June 9, 1992); Securities Exchange Act Release No. 27938 (Apr. 23, 1990), 55 FR 17949, 17950 (Apr. 30, 1990).

²¹ 15 U.S.C. 78o(g).

the nature of such broker's or dealer's business, to prevent the misuse . . . of material, nonpublic information by such broker or dealer or any person associated with such broker or dealer.”

Accordingly, the Exchange proposes to revise current Rule 98(c)(2) and replace it with new text based on NYSE Arca Equities Rule 6.3 (Prevention of the Misuse of Material Nonpublic Information) and BATS Rule 5.5 (Prevention of the Misuse of Material, Non-Public Information) that specifies that a member organization seeking approval to operate a DMM unit pursuant to Rule 98 must maintain and enforce written policies and procedures reasonably designed, taking into consideration the nature of such member organization's business, (i) to prevent the misuse of material, non-public information by such member organizations or persons associated with such member organization and (ii) to ensure compliance with applicable federal laws and regulations and with Exchange rules.²²

Similar to NYSE Arca Equities Rule 6.3, the Exchange further proposes to add rule text that provides examples of conduct that would constitute the misuse of material, non-public information, including, but not limited to: (A) trading in any securities issued by a corporation, or in any related products, while in possession of material-non-public information concerning the issuer; (B) trading in a security or related product, while in possession of material non-public information concerning imminent transactions in the security or related product; or (C) disclosing to another person or entity any material, non-public information involving a corporation whose shares are publicly traded or an

²² The Exchange also proposes to revise Rule 98(c)(1) to replace the term “NYSE Regulation, Inc.” with the term “Exchange.” Pursuant to Rule 0(c), the term “Exchange” may also mean FINRA staff working on behalf of the Exchange and NYSE Regulation, Inc. pursuant to a regulatory services agreement.

imminent transaction in an underlying security or related product for the purpose of facilitating the possible misuse of such material, non-public information.²³

The Exchange believes that with the proposed change to Rule 98(c)(2), member organizations will be able to utilize a flexible, principles-based approach to modify their policies and procedures as appropriate to reflect changes to their business model, business activities, or to the securities market itself. Moreover, while specified information barriers may no longer be required, a member organization's business model or business activities may dictate that an information barrier or functional separation be part of the appropriate set of policies and procedures that would be reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable Exchange rules.

More specifically, the Exchange notes that providing member organizations with the ability to integrate DMM unit operations with other equity trading operations, which may include customer-facing trading desks, would enable member organizations to better manage risk and adopt uniform trading models across multiple markets. Currently, because DMM units need to be walled off from other market-making desks, the DMM units cannot leverage quoting models that may have been developed for the other market-making desks. And because of the Rule 98-mandated separation, member organizations are restricted in their ability to manage risk across the DMM unit and other market-making units. As a result, the costs associated with developing separate quoting models and risk strategies for a stand-alone DMM unit become prohibitive as compared to a

²³ Because Rule 98 defines the term "related product," the Exchange proposes to use the term "related product" instead of "related security," which is the term used in NYSE Arca Equities Rule 6.3.

member organization's investment in operating an integrated market-making unit that may include both internalized customer flow and registered market-making on other exchanges. The Exchange believes that if DMM units could be integrated with other market-making units, it could not only enable member organizations to enhance their overall risk management, but could also potentially lead to flow that would otherwise be internalized being directed instead to the Exchange.

Consistent with the proposal to adopt a principles-based approach to protect against the misuse of material non-public information generally, the Exchange proposes to restructure the defined terms in current Rule 98 that relate to non-public information. First, the Exchange proposes to re-define the definition of "non-public information" as "Floor-based non-public information." The Exchange proposes this redefinition to distinguish this type of non-public information, which is non-DMM information to which a DMM while on the Trading Floor may have access due to the unique role of DMMs on the Trading Floor, from any other non-public information that is covered by proposed Rule 98(c)(2). As discussed in more detail below, the Exchange proposes to maintain restrictions in proposed Rule 98(c)(3) tailored to the Floor-based activities of DMM units and proposes to use the term "Floor-based non-public order information" to distinguish which information those provisions are intended to protect.²⁴

Second, the Exchange proposes to delete the definition of DMM confidential information as duplicative of proposed new Rule 98(c)(2), which protects against the

²⁴ The Exchange proposes non-substantive changes to this definition that better reflect how Exchange systems currently operate. Specifically, the Exchange believes that concept of trading in "slow mode" is duplicative of the remaining rule text, which covers any order information that is made available to DMMs but that is not available to other market participants.

misuse of material non-public information. As noted above, the term “DMM confidential information” includes position, trading, and quoting information of the DMM unit. This information is non-public to persons or entities that are not part of the member organization, but critical information for a member organization to operate and manage its own risks. The Exchange believes that the policy concerns relating to specifying separate protections for this information are no longer applicable. Specifically, unlike specialists, DMMs are not agents for orders on the Exchange’s book and do not have any negative obligations. Instead, DMMs are required to act as market makers in assigned securities, subject to affirmative obligations to maintain a fair and orderly market.²⁵ While the DMM continues to have the ability to, and does, trade manually from the Floor, the vast majority of the DMM’s quotes are entered by means of algorithms initiated off-Floor. Moreover, DMM interest manually entered intraday during a slow state or to participate in a verbal transaction with a Floor broker still yields to public orders.²⁶ In addition, to the extent a DMM on the Floor may have access to Floor-based non-public order information, proposed Rule 98(c)(3) would continue to specify protections against the misuse of that information by the member organization.

The Exchange believes that the proposed principles-based approach to protect against the misuse of material non-public order information specified in proposed Rule 98(c)(2) would ensure that a member organization would be required to protect against the misuse of any material non-public information that currently falls within the definition of DMM confidential information. As noted above, this includes refraining from trading while in possession of material non-public information concerning imminent

²⁵ See Rule 104 - Equities.

²⁶ See Rule 72(c)(xi) - Equities.

transactions in the security or related product. The Exchange believes that moving to a principles-based approach rather than prescribing how and when to protect the DMM's own quoting and trading information would provide member organizations operating DMM units with appropriate tools to better manage risk across a firm, including integrating DMM unit positions and quoting information with other quotes and positions by the firm, or as applicable, by the respective independent trading unit. Specifically, the Exchange believes that it is appropriate for risk management purposes for a member organization operating a DMM unit to be able to consider both DMM unit outstanding quotes as well as traded positions for purposes of calculating net positions consistent with Rule 200 of Regulation SHO, calculating intra-day net capital positions, and managing risk both generally as well as in compliance with Rule 15c3-5 under the Act (the "Market Access Rule").²⁷ The Exchange notes that any risk management operations would need to operate consistent with the requirement to protect against the misuse of material non-public information.

The Exchange notes that if DMM units are integrated with other market-making operations, they would be subject to existing rules that prohibit member organizations from disadvantaging their customers or other market participants by improperly capitalizing on a member organization's access to the receipt of material, non-public information. As such, a member organization that integrates its DMM unit operations together with customer-facing operations would need to protect customer information consistent with existing obligations to protect customer information that already apply to equity market makers registered on other exchanges. For example, Rule 5320 – Equities

²⁷ 17 CFR Part 240.15c3-5.

(“Rule 5320”), which is substantially similar to FINRA Rule 5320, NYSE Rule 5320 and NYSE Arca Equities Rule 5320 (generally referred to as the “Manning Rule.”), generally prohibits a member organization from trading for its own account ahead of customer orders. Rule 5320(a) further provides that if a member organization trades at a price for its own account ahead of the customer order, it must execute the customer order up to the size and at the same or better price at which it traded for its own account. The Manning Rule sets forth certain exceptions to this requirement, including the Large Orders and Institutional Account Exceptions (Supplementary Material .01 to Rule 5320) and the No-Knowledge Exception (Supplementary Material .02 to Rule 5320). A member organization operating both a DMM unit, which engages in trading for its own account, and customer-facing operations would need to comply with the Manning Rule or meet one of the specified exceptions.²⁸ In addition, a member organization operating a DMM unit would also need to maintain policies and procedures to assure that it does not engage in any frontrunning of customer order information in violation of Exchange, FINRA, or federal rules. The Exchange notes that these are existing obligations that already govern equity market-making operations on other exchanges and therefore integrating DMM operations with such desks would not present any novel issues.

Proposed Rule 98(c)(3) – (7) would set forth the remaining specific restrictions for member organizations operating a DMM unit. In recognition of the unique role of DMMs, including limited Floor-based access to certain non-public order information,²⁹ the Exchange proposes to maintain certain prescriptions on how a DMM unit must

²⁸ The Exchange notes that FINRA already monitors member organizations for compliance with Rule 5320.

²⁹ See Rule 104(j)(ii) - Equities.

operate. To effect this new structure, the Exchange proposes to delete subsections (d) and (f) of Rule 98 and move the sections of those rules that the Exchange proposes to retain to an amended subsection (c)(3) – (7) of the Rule, which include the relevant restrictions on trading within the unit. As proposed, the rule will no longer prescribe the type of trading in which a DMM unit may engage. Rather, the proposed rule will only specify the types of trading activities that would be restricted.

Proposed Rules 98(c)(3)(A) – (D) would set forth the restrictions specific to DMM units that address their unique role at the Exchange. Proposed Rule 98(c)(3)(A) would provide generally that a member organization shall protect against the misuse of Floor-based non-public order information. The rule would further specify who may have access to such Floor-based non-public order information (as permitted pursuant to Rule 104 - Equities), which, as proposed, would be the Floor-based employees of the DMM unit and individuals responsible for the direct supervision of the DMM unit's Floor-based operations. The Exchange believes that the proposed rule change specifies in a more straight-forward manner who may have access to have non-public order information, and replaces the multiple references in the current Rule 98 to the same concept.³⁰

Proposed Rule 98(c)(3)(B) would specify the restrictions applicable to employees of the DMM unit while on the Trading Floor. First, while on the Trading Floor of the Exchange, employees of the DMM unit, except as provided for in Rule 36.30 - Equities, may trade only DMM securities and only on or through the systems and facilities of the

³⁰ See, e.g., Rules 98(c)(2)(A)(i) – (ii), (d)(2)(B)(i) – (iii), (f)(1)(A)(i), (f)(3)(C)(ii). The current rule is structured as to who may not have access. The Exchange believes it is clearer to specify who may have access to such information.

Exchange, as permitted by Exchange Rules.³¹ Second, while on the Trading Floor, Floor-based employees may not communicate with individuals or systems responsible for making trading decisions for related products or for away-market trading in DMM securities.³² Finally, because a DMM unit may be part of a larger trading unit that includes customer-facing operations, the Exchange proposes to add a new restriction that while on the Trading Floor, employees of the DMM unit shall not have access to customer information or the DMM unit's position in related products.³³ The Exchange believes that these proposed restrictions will ensure that while on the Floor, employees of a DMM unit will not be quoting or trading based on material non-public information related to customer information or trading in related products.

As with the current rule, the Exchange proposes to maintain restrictions on what happens if a non-Floor based individual becomes aware of Floor-based non-public order information. The Exchange proposes to consolidate the current rule concerning wall-crossing provisions into proposed Rule 98(c)(3)(C), which would provide that when a Floor-based employee of a DMM unit moves to a location off of the Trading Floor of the Exchange or if any person that provides risk management oversight or supervision of the

³¹ Compare proposed Rule 98(c)(3)(A) with Rule 98(f)(1)(A)(ii). The Exchange also proposes to replace the term "Floor" with the term "Trading Floor" to reflect the use of that term in Rules 6A - Equities and 36 - Equities.

³² Compare proposed Rule 98(c)(3)(B) with Rule 98(d)(2)(B)(iii).

³³ Compare proposed Rule 98(c)(3)(B)(iii) with Rule 98(f)(1)(A)(ii). In addition, the Exchange believes that proposed Rule 98(c)(3)(B)(iii) replaces the concerns expressed in current Rule 98(c)(2)(C) that the DMM unit not have access to material non-public information that is in possession of other aggregation unit. The Exchange does not believe it needs to maintain Rule 98(c)(2)(C) because it restates the general concept of how aggregation units under Regulation SHO are structured, and as noted above, Rule 98 no longer follows the aggregation unit model.

Floor-based operations of the DMM unit is aware of Floor-based non-public order information, he or she shall not (1) make such information available to customers, (2) make such information available to individuals or systems responsible for making trading decisions in DMM securities in away markets or related products, or (2) use any such information in connection with making trading decisions in DMM securities in away markets or related products.

The Exchange believes that consolidating the wall-crossing provisions into a single provision achieves the same purpose as the current rule, which states the same concept in multiple places.³⁴ The proposed rule is augmented by adding that Floor-based non-public order information cannot be made available to customers. The proposed rule would cover any individual, whether it is an individual that leaves the Floor or a manager providing oversight of Floor operations, to neither use nor make available any non-public order information that the individual becomes aware of. The Exchange believes that replacing the concept of “access to” information with “aware of” information provides a clearer standard for member organizations and is generally more consistent with federal rules.³⁵ Specifically, because the provision is intended to ensure that information is not used inappropriately, inappropriate use of such information could only occur if someone is aware of that information.

For example, a DMM unit could be part of a larger trading unit that engages in customer-facing market making activities on multiple exchanges. With the proposed

³⁴ See Rules 98(c)(2)(E)(i), 98(d)(2)(B)(iv), and (f)(1)(A)(3).

³⁵ See 17 CFR 240.10b5-1(b) (specifying that a purchase or sale of securities constitutes trading on the basis of material nonpublic information when the person making the purchase or sale was aware of the material nonpublic information when the person made the purchase or sale).

changes to Rule 98 generally, a manager within that unit would be able to monitor risk across the unit, including positions from trading as a DMM at the Exchange, without breaching any prohibitions against the misuse of material nonpublic information. Assume that a Floor-based DMM needs to take on a larger risk profile in a security because of a proposed Floor broker transaction and needs to discuss this proposed transaction with the off-Floor manager. Once this topic is discussed with the off-Floor manager, that manager is now aware of Floor-based non-public order information, and therefore must protect against the misuse of this information. This type of wall-crossing procedure is consistent with current practices within member organizations.

As with the current rule, but with new rule numbering, the Exchange proposes to maintain that the DMM unit may make available to a Floor broker associated with or affiliated with an approved person or member organization any information that the DMM would be permitted to provide under Exchange rules to an unaffiliated Floor broker.³⁶

To ensure that all trading activity by a DMM unit in DMM securities at the Exchange is available for review, the Exchange proposes to add a provision that any interest entered by the DMM unit in DMM securities at the Exchange must be entered through systems that identify such interest as DMM interest.³⁷ As proposed, because the Exchange's trading systems continue to evolve, the Exchange believes it is unnecessary to specify which system(s) a DMM unit must use. However, this rule would require the

³⁶ Compare proposed Rule 98(c)(3)(D) with Rule 98(c)(2)(A)(ii). The Exchange proposes to replace the term "DMM" with "DMM unit" to be clear that the proposed rule covers any staff of the DMM unit located on the Trading Floor.

³⁷ See proposed Rule 98(c)(4).

DMM unit to use a system that would enable such interest to be identified as DMM trading interest.

The Exchange notes that the Rule 104 obligations that relate to whether a DMM is long or short, i.e., Rules 104(g)(i)(A)(III) and (h) - Equities, are applicable to the DMM unit's position in DMM securities together with any position of a Regulation SHO independent trading unit of which the DMM unit may be included. For example, if a DMM unit is combined with market-making desks that are trading on away markets, it would be the position of that entire unit in DMM securities, and not just the DMM's Exchange-traded positions, that would be relevant for those rules. To ensure that the Exchange can monitor for compliance with these rules, the Exchange proposes to add to Rule 98 that the member organization must provide the Exchange with real-time unit position information for any trading in DMM securities by the DMM unit and any independent trading unit of which it is a part.³⁸ For example, if a DMM unit is part of an independent trading unit that engages in trading on other markets in DMM securities, the real-time position update would need to incorporate any away-market transactions in DMM securities by that independent trading unit.

Currently, Rule 98 permits an integrated proprietary aggregation unit to engage in options market making (electronic only), provided that the DMM unit is walled off from the options market making trading desk. Similar to NYSE Arca Equities, the Exchange proposes to eliminate prescriptive rules regarding how to structure DMM operations together with other market-making operations, and instead believes that the principles-

³⁸ See proposed Rule 98(c)(5). The Exchange proposes to delete Rule 98(d)(4) and subparagraphs from the rule both because the Exchange does not believe it needs to separately identify DMM audit trail requirements and because Rule 132B - Equities no longer exists.

based approach set forth in proposed Rule 98(c)(2) should protect against the misuse of material nonpublic information.³⁹ The Exchange proposes to amend Rule 98 to specify restrictions that are unique to the Exchange by virtue of the close physical proximity of the NYSE Amex Options LLC (“NYSE Amex Options”) trading floor. As proposed, the DMM unit may not operate as a specialist or market maker on the Exchange or the NYSE Amex Options trading floors in related products, unless specifically permitted in Exchange rules.⁴⁰ The Exchange notes that a member organization that operates a DMM unit may be a specialist or market maker on NYSE Amex Options trading floor provided that it maintains appropriate information barriers.

The Exchange also proposes to maintain the existing requirement that the member organization maintain information barriers between the DMM unit and any investment banking or research departments.⁴¹ The amended rule would also continue to provide that no DMM or DMM unit may be directly supervised or controlled by an individual associated with an approved person or the member organization who is assigned to any investment banking or research departments.⁴² The only difference between the proposed rule text and the current rule is that the Exchange proposes to delete that a DMM unit may not be supervised or controlled by an individual assigned to a customer-facing department. As noted above, the Exchange believes that member organizations should

³⁹ See footnote 4.

⁴⁰ See proposed Rule 98(c)(6). The Exchange notes that currently, the only time that a DMM unit may engage in market making in a related products is pursuant to Rule 504(b)(5) – Equities.

⁴¹ Compare proposed Rule 98(c)(7) with 98(c)(2)(A)(i) and (c)(2)(C). Investment banking activities include activities such as underwriting, tender offers, mergers, acquisitions, recapitalizations, etc. See Rule 98(f)(1).

⁴² Compare proposed Rule 98(c)(7) with Rule 98(c)(2)(E)(ii).

not be restricted in their ability to combine DMM operations with customer-facing operations, subject to the restrictions enumerated in amended Rule 98 and the proposed Exchange and federal requirements that prohibit the misuse of material nonpublic information, discussed above.

The Exchange also proposes to provide in proposed Rule 98(d) that the DMM rules will apply only to the DMM unit's quoting or trading in their DMM securities for their own accounts at the Exchange.⁴³ The Exchange has added that this restriction is only applicable to DMM unit trading for their own account to be clear that the DMM rule restrictions are not applicable to any customer orders routed to the Exchange by that member organization as agent.

The Exchange believes that by restructuring the rule to focus on protecting against the misuse of material non-public information, Rule 98 no longer needs to specify how a member organization or an approved person provides back-office support operations, such as clearing, stock loan, and compliance, for the DMM unit. Rather, the Exchange believes that how a member organization or approved person provides back-office operations to the DMM unit should not differ from how such services are provided to other trading units within that member organization or approved person. In addition, as proposed, amended Rule 98(c)(2) would require the member organization to protect against the misuse of material non-public information, which would govern all aspects of

⁴³ Compare proposed Rule 98(d) with Rules 98(c)(3) and (d)(3). As defined in proposed Rule 98(b)(3) (formerly, Rule 98(b)(5)), the DMM rules mean any rules that govern DMM conduct or trading. These would include, for example, Rules 36.30 - Equities, 103 - Equities, 103A - Equities, 103B - Equities, and 104 - Equities.

a member organization's operations. Accordingly, the Exchange proposes to delete in its entirety Rule 98(e).

The Exchange notes that if a person in the member organization or an approved person is providing non-trading related services to the DMM unit, and as a result of such relationship, becomes aware of Floor-based non-public order information, such person would be subject to the wall-crossing provisions of proposed Rule 98(c)(3)(C), which is applicable to any person who is aware of such information. Because these protections for Floor-based non-public order information are retained in the proposed revisions to Rule 98, and are applicable to approved persons pursuant to proposed amended Rule 98(a)(1), the Exchange believes that Rule 98(e), which concerns the sharing of non-trading related services, is redundant of existing regulatory requirements governing the operations of a broker-dealer. The Exchange proposes conforming amendments to Rule 36.30 - Equities.

Because of the proposed restructuring of the rule, Rule 98(g) will be renumbered as Rule 98(e), Rule 98(h) will be renumbered as Rule 98(f), and Rule 98(i) will be renumbered as Rule 98(g). The Exchange is proposing conforming changes to these sections, including updating cross-references and changing the reference from the Division of Market Surveillance and NYSE Regulation to the Exchange.⁴⁴

C. Other Proposed Amendments

As noted above, all DMM firms for which Rule 98 is applicable are now under the auspices of Rule 98. Accordingly, Rule 98 Former no longer has any application for any DMM units. The Exchange therefore proposes to delete Rule 98 Former and any rule that either references Rule 98 Former, i.e., Rule 104T(a)(Former) and supplementary

⁴⁴ Pursuant to Rule 0(c), the reference to the Exchange in this rule may also mean FINRA.

material .13 (Former), or references a rule that is being proposed for deletion, e.g., Rule 900. The Exchange also proposes to amend Rule 98(a) and 105 to delete references to Rule 98 Former.

In addition, the Exchange proposes to amend Rule 105 – Equities (“Rule 105”) to delete Rule 105(b) – (d) and the Guidelines for DMM’s Registered Security Option and Single Stock Futures Transactions Pursuant to Rule 105 (“Rule 105 Guidelines”) and make conforming amendments to Rule 36.30 - Equities.⁴⁵ Rule 105 currently sets forth hedging guidelines to permit the DMM to trade listed options or single-stock futures that overlay DMM securities from the Trading Floor. Under Rule 98(f)(1), a DMM unit can obtain an exemption from the Rule 105 Guidelines to trade options or futures, provided that such trading is conducted by a walled-off, off-Floor trading desk.

Under proposed revisions to Rule 98, a DMM unit would no longer need to apply for an exemption from Rule 105 trading restrictions because, as discussed above, while on the Trading Floor, Floor-based employees may trade only DMM securities, i.e., no related products, and only on or through the systems and facilities of the Exchange. Because there would not be any Floor-based trading in listed options or single-stock futures, the Rule 105 Guidelines specifying how such Floor-based trading may occur are now moot. Accordingly, the Exchange proposes to delete these rules.

In addition, because DMM units no longer have customer relationships, the Exchange proposes to delete in its entirety the DMM Booth Wire Policy, which is set forth in Rule 123B - Equities, as obsolete.

⁴⁵ The Exchange proposes to amend Rule 105(a) to clarify that the restriction on pool dealing applies to the DMM unit for securities registered to that unit and revise the title of the rule accordingly.

The Exchange notes that all member organizations currently operating DMM units already have in place written policies and procedures to comply with Rule 98, and such policies and procedures have been approved by NYSE Regulation.⁴⁶ In addition, FINRA has an exam program that reviews member organizations operating DMM units for compliance with such procedures. Because the proposed Rule 98 amendments would continue to require Exchange approval of any policies and procedures to protect against the misuse of material nonpublic information, if a member organization chooses to modify how it operates its DMM operations consistent with amended Rule 98, such revised policies and procedures would be subject to Exchange review before they could be implemented. In addition, once implemented, FINRA would continue to monitor a member organization's compliance with those policies and procedures consistent with the current exam-based regulatory program associated with Rule 98.

In addition, FINRA already has in place surveillances designed to monitor for manipulative activity and the Exchange believes that because DMM market-making activity is not materially different from market-making on other exchanges, these existing programs are reasonably designed to address any concerns that may be raised by a DMM unit being integrated with existing market-making operations.

2. Statutory Basis

The basis under the Act for this proposed rule change is the requirement under Section 6(b)(5)⁴⁷ that an Exchange have rules that are designed to promote the just and equitable principles of trade, to remove impediments to and perfect the mechanism of a

⁴⁶ FINRA currently approves Rule 98 procedures on behalf of NYSE Regulation, Inc. pursuant to a regulatory services agreement. See supra footnote 22.

⁴⁷ 15 U.S.C. 78f(b)(5).

free and open market and a national market system and, in general, to protect investors and the public interest. The Exchange believes that the proposed rule change would remove impediments to and perfect the mechanism of a free and open market by adopting a principles-based approach to permit a member organization operating a DMM unit to maintain and enforce policies and procedures to, among other things, prohibit the misuse of material non-public information and eliminating restrictions on how a member organization structures its DMM unit operations. The proposed amendments maintain the existing Rule 98 restrictions that are specific to the unique role of the DMM and also maintain the information barrier requirements between the DMM unit and any investment banking or research departments. Member organizations operating DMM units will continue to be subject to federal and Exchange requirements for protecting material non-public order information⁴⁸ and protecting customer orders that are the consistent with the existing rules governing broker dealers that operate as equity market makers on other registered exchanges.⁴⁹

Accordingly, while certain prescriptive elements of Rule 98 are being deleted, the Exchange notes that the rule will still require that member organizations maintain and enforce policies and procedures reasonably designed to ensure compliance with applicable federal securities laws and regulations and with Exchange rules. The Exchange notes that such written policies and procedures will continue to be subject to oversight by the Exchange and therefore the elimination of prescribed restrictions should not reduce the effectiveness of the Exchange rules to protect against the misuse of material non-public information. Rather, member organizations will be able to utilize a

⁴⁸ See 15 U.S.C. 78o(g) and proposed Rule 98(c)(2).

⁴⁹ See Rule 5320.

flexible, principles-based approach to modify their policies and procedures as appropriate to reflect changes to their business model, business activities, or to the securities market itself. Moreover, while specified information barriers may no longer be required, a member organization's business model or business activities may dictate that an information barrier or functional separation be part of the appropriate set of policies and procedures that would be reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable Exchange rules. The Exchange therefore believes that the proposed rule change will maintain the existing protection of investors and the public interest that is currently set forth in Rule 98, while at the same time removing impediments to and perfecting a free and open market by moving to a principles-based approach to protect against the misuse of material non-public information.

The Exchange similarly believes that deleting the definition of "DMM confidential information" removes impediments to and perfects the mechanism of a free and open market as it will enable a member organization to share quoting and position information as may be necessary to meet order marking requirements under Regulation SHO or to comply with the Market Access Rule. The Exchange further believes that the proposed adoption of a principles-based approach to protect against the misuse of material non-public information, including specifically requiring refraining from trading based on material non-public information regarding imminent transactions in a security or related product, will protect investors and the public interest because it will assure the protection against the misuse of material non-public information and delete prescribed rules that may no longer meet this goal.

The Exchange also believes that amending Rule 98 to apply wall-crossing procedures to any individual who is aware of non-public order information both broadens the protection of the rule to any individual, while at the same time narrowly tailors the rule to when such protections should apply, i.e., when an individual is aware of non-public order information and therefore could be in a position to make a purchase or sale of securities on the basis of such material nonpublic information. The Exchange believes that such clarifying changes remove impediments to and perfect the mechanism of a free and open market by assuring that the protections are applied when necessary.

In addition, the Exchange believes that deleting Rule 98 Former and all references thereto in Exchange rules removes impediments to and perfects the mechanism of a free and open market because Rule 98 Former no longer governs any member organizations or approved persons that operate a DMM unit, nor would it be applicable to any new DMM units, and therefore deleting the rule reduces any potential confusion of which version of Rule 98 is applicable. For similar reasons, because DMMs would not be permitted to trade in related products while on the Trading Floor, the Exchange believes that the Rule 105 Guidelines are now moot, and deleting such rule reduces any potential confusion of which rules govern DMM unit trading in related products. Finally, the Exchange believes that deleting the Booth Wire Policy reduces confusion as such policy is now moot given that DMMs do not have public customers.

B. Self-Regulatory Organization's Statement on Burden on Competition

The Exchange does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. The Exchange operates the only-Floor-based equities market with DMMs.

As such, any changes to Rule 98 would not impact any other markets. However, the Exchange believes Rule 98 currently imposes a burden on competition for the Exchange because it requires member organizations that operate a DMM unit to operate in a manner that the Exchange believes is more restrictive than necessary for the protection of investors or the public interest. The Exchange believes that the proposed rule change is pro-competitive because it adopts a principles-based approach that prohibit the misuse of material non-public information that is consistent with the rules of NYSE Arca, BATS, and Nasdaq governing equity market makers and should provide greater flexibility for how a member organization could structure its operations.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

No written comments were solicited or received with respect to the proposed rule change.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

- (A) by order approve or disapprove the proposed rule change, or
- (B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with

the Act. Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-NYSEMKT-2014-22 on the subject line.

Paper comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-NYSEMKT-2014-22. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Section, 100 F Street, NE, Washington, DC 20549-1090. Copies of the filing will also be available for inspection and copying at the NYSE's principal office and on its Internet website at www.nyse.com. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information

that you wish to make available publicly. All submissions should refer to File Number SR-NYSEMKT-2014-22 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.⁵⁰

Kevin M. O'Neill
Deputy Secretary

[FR Doc. 2014-07635 Filed 04/04/2014 at 8:45 am; Publication Date:
04/07/2014]

⁵⁰ 17 CFR 200.30-3(a)(12).